

# The Nature and Method of Economics

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PRINCIPLES OF ECONOMICS (ECON 210)

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# What students will learn in this class

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- The economic way of thinking.
  - The most valuable skill students will practice.
  - A broadly applicable method of explaining human behavior, individually and collectively.
  - Economics is a social science.
- Also tools to describe models (testable predictions about human behavior), express thoughts:
  - Vocabulary to describe models concisely and accurately,
  - Graphing skills used to illustrate a model's assumptions and implications,
  - Arithmetic to derive quantifiable implications of models.

# The Economic way of thinking

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- Scarcity and choice. The basic problem: allocating limited resources among unlimited wants.
  - Choice solves the problem by allocating resources to some wants instead of others.
  - Economists study the bases for choices and the consequences of the resulting allocations.
- Rational behavior differentiates economics from other social sciences.
  - People as purposeful seekers of their wants—whatever they may be.
  - Attempt to fulfill their wants as amply as possible, given the constraints of scarcity.
  - They behave as if trying to accomplish some objective to which their choices move them closer.

# The Economic way of thinking

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- Marginalism. Rarely do choices require revisions to one's entire life plan, more often only small "tweaks": small incremental changes. Examples:
  - "Buy a new car today or wait another month?"
  - "16 oz. pack of cheese or 24 oz. pack?"
  - "Play golf or play basketball on Saturday?"
- These all involve "one more" or "one less" of something, taking the broader plan as given. The calculation is based on marginal benefits and marginal costs. I.e.,
  - "What do I get from 1 more?"
  - "What do I have to give up to get 1 more?" and
  - "Is it worth it?"

# Economics principles' origins: the scientific method

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- Observe the real world and record facts.
  - E.g., “when workers quit a job, the new job they accept usually has a higher wage.”
- Form a hypothesis.
  - “Workers quit because they searched for and found a better job, and ‘better’ usually includes a higher wage.”
- Test the hypothesis. Compare its prediction to observed outcomes.
  - E.g., “Does the introduction of a search engine that makes vacancies easier to find increase quitting?”
  - Corollary. A valid test is conducted in a ceteris paribus environment. Other factors affecting quit behavior are explicitly or statistically controlled, as in a laboratory setting.
- Confirm or reject the hypothesis. Modify the rejected hypothesis if possible and repeat step 3.
- As repeated tests confirm predictions, a theory evolves.
- Theories that gain wide acceptance and favorable test results evolve into economic laws or principles.

# Organizational structure: micro vs. macro

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Research is focused on one or two specific fields at a time. The most famous way of sub-dividing studies is based on micro or macro.

- Microeconomics analyzes the choices of individual households or firms within specific markets.
- Macroeconomics analyzes the performance of an economy overall—the aggregation of many households, firms, and markets.

# Organizational structure: the JEL codes

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A more colorful way of illustrating the areas economists focus on. The American Economic Association made the JEL (Journal of Economic Literature) [system](#) to classify economic research more descriptively.

- Other classes in our department, e.g., “International,” “Industrial Organization,” and “Labor Economics.”
  - The sub-fields within each of these gives an even better picture of what each field studies.
  - They may also be useful for choosing other economics electives, based on a student’s interests.

Theoretical and empirical.

- Fields can be further divided according to the formulation and testing of hypotheses:

Formulation → *Theory*

Testing → *Empiricism.*

# Conclusion

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This class:

- Primarily theory.
  - Methods used in empirical economics are taught in other classes: statistics and econometrics.
- Emphasizes microeconomic theory over macroeconomics.
  - The former is the building block of the latter. It is possible to learn many useful insights about behavior without aggregating to the macro level; the reverse is not true.
- Wherever possible we will explore applications to current events, policy discussions, and students' stated interests.